Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Hayden	Analyst:	Roger Lackey	Bill Number:	SB 1710
Related Bills:	None	Telephone:	845-3627	Amended Date:	04-25-2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: 2000 Public Subsidies & Public Benefits Act/Taxpayers Report Business Tax Expenditures Information & FTB Collect & Report Information To Legislature

SUMMARY OF BILL

This bill would create the 2000 Public Subsidies and Public Benefits Act. It would require certain legislative entities to review the economic and employment impact of state business tax expenditures and all other public subsidies no later than December 31, 2005.

Further, it would require taxpayers to provide the Franchise Tax Board (FTB) specific information regarding the taxpayers "business tax expenditures" and "public subsidies."

This analysis will address the bill only to the extent it impacts the department.

SUMMARY OF AMENDMENTS

The April 25, 2000, amendments deleted the legislative intent language and added the provisions described above.

The department did not analyze this bill as introduced February 22, 2000.

EFFECTIVE DATE

This bill would be effective and operative January 1, 2001.

SPECIFIC FINDINGS

Existing state income tax law contains a variety of tax expenditures, including exclusions, deductions, exemptions, and credits that may be used to reduce either taxable income or tax liability owed by a taxpayer, estate, trust, or corporation.

Tax expenditures can be mandated by federal law or by the state Constitution, such as the exemption from taxation for interest on bonds issued by the federal government, the state, or a local government in California. However, most tax expenditures are enacted by the Legislature and signed into law by the Governor.

The **Constitution of the State of California** requires the Governor to propose an annual budget every year, which is introduced in the Legislature by January 10 as the Budget Act, and the Legislature must send a budget bill to the Governor by June 15 for signature. Tax expenditures are not listed separately in the annual state Budget Act.

Board Position:			Department Director	Date
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While the individual bill creating a tax expenditure is being examined by the Legislature, the revenue impact to the State is estimated by the Department of Finance (DOF) and, in the case of income and franchise tax expenditures, the Franchise Tax Board. When a new tax expenditure is enacted into law, the revenue estimate becomes part of the state's fiscal baseline for the next fiscal year. The state's fiscal baseline is adjusted every year based on the prior year actual revenues and expenditures.

Certain items on a filed tax return are keyed into the department's computer system, such as the taxpayer's adjusted gross income, the total tax liability, and the amount of withheld tax. Many tax expenditures are combined before being keyed into the system so that particular expenditures are not recorded. For example, for an individual taxpayer who itemizes deductions, the amount keyed into the system is the difference between the sum of itemized deductions claimed on the federal schedule and those deductions which were disallowed (or partially disallowed) under state law.

The due date for personal income tax returns is generally April 15, with an extended due date of October 15. Corporate returns are due two months and 15 days after the close of the corporation's income year with an extension of seven months. The first original due date for corporate returns using a calendar year is March 15, and the original due date for the latest possible fiscal year (December 1 to November 30) would be the next February 15. With these time frames, the department finishes compiling the year's return information in January of the second succeeding year for personal income tax and in July of that second succeeding year for corporate returns. For example, the information for the 2000 taxable year for personal income tax returns will be compiled in January 2002, and for corporate returns in July 2002.

This bill would create the 2000 Public Subsidies and Public Benefits Act. It would require the Legislative Analyst's Office (LAO), in consultation with the Assembly and Senate Revenue and Taxation Committees and the Legislature, to review the economic and employment impact of state business tax expenditures and all other public subsidies no later than December 31, 2005.

Each business tax expenditure would be independently reviewed by the LAO, in consultation with certain legislative entities. Upon review by the LAO, the Legislature would make a determination whether to discontinue the business tax expenditure.

As part of the business tax expenditure review, the FTB, in consultation with the DOF, would have to estimate information regarding direct employment generated in California, economic benefits for communities of high unemployment and economic disadvantage, and citations for violations of labor or environmental codes during the reporting period. This information would be reported to the Legislature.

In order to make these estimates, **this bill** would require taxpayers to provide the FTB with specific information regarding the taxpayers' "business tax expenditures." The information would include:

- The number of full-time employees employed by the taxpayer in this state on December 1 of the tax year.
- The taxpayer's investment during the tax year in real property and property as defined by Section 1245 of the Internal Revenue Code.
- Citation or other notification of any violations of state or federal environmental or employment laws received during the tax year.

"Business tax expenditures" for purposes of this bill would include credits, deductions, exemptions, exclusions, special tax rates, and other preferences claimed by a taxpayer in the course of trade or business. However, it would not include the homeowner's exemption or charitable contributions.

This bill also would require taxpayers to report to the FTB their total investment in California due to a specific public subsidy. The taxpayers would provide the most accurate estimates of direct and indirect employment generated in California, economic benefits for communities of high unemployment and economic disadvantage, and citations for violations of labor or environmental codes during the reporting period. However, the public subsidy portion of the bill does not specify what the FTB would do with this information.

"Public subsidy" would be defined as state assistance in the form of cash or services provided to an individual firm or business for:

- encouraging the development of products or improving manufacturing or other processes;
- promoting research and technology;
- influencing the location or expansion of a trade or business;
- providing planning or managerial support for a trade or business;
- facilitating compliance with any applicable state or federal law or regulation; or
- providing financial assistance, such as loans or loan guarantees.

Implementation Considerations

This bill would provide that the LAO, in consultation with the Senate and Assembly Revenue and Taxation Committees and the Legislature, review each business tax expenditure. However, the information required to be reported by the taxpayer to the FTB (number of full-time employees, real property and 1245 property, as defined by the IRC, and violations of environmental or employment law) would not be sufficient to provide the LAO the necessary information to review each business tax expenditure. If it is intended that tax return information would be used to review business tax expenditures, the time required for the department to compile statistics may make the review by the LAO and the Legislature of each existing "business tax expenditure" by December 31, 2005, difficult to accomplish.

State tax law contains a number of distinctions between types of taxpayers. For example, the minimum franchise tax for certain corporations involved in gold or quicksilver mining is $25, rather than $800. Limited liability companies are required to pay an $800 tax and a fee, while limited liability partnerships pay only an $800 tax. S Corporations are not subject to the alternative minimum tax and pay a lower franchise tax rate than other corporations. Individuals are taxed at graduated rates ranging from 1% to 9.3%. Many organizations, such as churches and nonprofit charities, are exempt from taxation, except in limited cases when nonprofit organizations have unrelated business taxable income. It is unclear whether these and the numerous other differences in tax treatment would be considered "special tax rates" or "other preferences."

Estimating direct employment generated and economic benefits for specified communities is outside the scope of the FTB’s expertise. Moreover, it is unclear how the department would verify the accuracy of a taxpayer’s reporting of the number of full-time employees or any violations of environmental or employment laws. While taxpayers would be required to report specific information to FTB, the bill provides no penalty if taxpayers fail to comply with the reporting requirements.

The reporting requirement under the public subsidy portion of the bill would be difficult to implement within the department’s normal systems. Taxpayers would be reporting information to the department about public subsidies even though the department does not administer any public subsidies and does not have a mechanism to collect or verify such information. Also, the wording requires the taxpayers to make estimates regarding employment, economic benefits, and labor and environmental violations. Such estimates may be outside the expertise of most taxpayers. The department is directed to make similar estimates under the business tax expenditure portion of the bill. Also, the public subsidy portion does not specify that the department is required to provide the information to the LAO for its review of public subsidies.

LEGISLATIVELY MANDATED REPORTS

This bill would provide that the LAO, with the assistance of certain legislative committees, the FTB and other departments, provide to the Legislature specific reports regarding “business tax expenditures.”

FISCAL IMPACT

Departmental Costs

Until the implementation concerns are resolved, department costs cannot be accurately determined. However, if new mechanisms must be created to collect information which is not part of the tax system, costs could be significant.

Tax Revenue Estimate

This bill would not impact the state’s income tax revenue.

BOARD POSITION

Pending.